BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
FIRST NATIONAL BANK OF OCEANSIDE)

Appearances:

For Appellant: J. C. Hizar, Attorney at Law

For Respondent: Chas. J. McColgan, Franchise Tax Commissioner

O P I N I O N

This is an appeal pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Chap. 13, Stats, 1929, as amended from the action of the Franchise Tax Commissioner in overruling the protest of First National Bank of Oceanside to a proposed assessment of an additional tax of $101.21 for the year 1932, based upon its return for the calendar year ended December 31, 1931.

The only question involved in this appeal is whether Appellant is entitled to deduct as bad debts, ascertained to be worthless during the year 1931, certain bonds which the Appellant was required by the National Banking Examiners to charge off during the year 1931.

Section 8(e) of the Act provides that in arriving at the net income to be used as a measure of the tax, there may be deducted from gross income

> "Debts ascertained to be worthless and charged off within the taxable year, or, in the discretion of the commissioner, a reasonable addition to a reserve for bad debts. When satisfied that a debt is recoverable in part only, the commissioner may allow such debt to be charged off in part."

There is some question whether bonds can be regarded as debts within the meaning of Section 8(e). However, in our view of the instant case, we do not believe it necessary to decide whether bonds are, or are not, to be regarded as debts within the meaning of this section.

Although it is not necessary for a taxpayer to resort to legal remedies to establish the worthlessness of a debt (Selden v. Heiner, 12 Fed. (2d) 474) the mere fact that a taxpayer considers a debt worthless and charges it off does not entitle him to a deduction (Chicago Ry. Equipment Co., 4 B.T.A. 452). There must be evidence that the debt was determined worthless and not simply that the debt was of doubtful value (Alemite Die Casting

& Mfg. Co., 1 B.T.A. 548). The taxpayer must employ reasonable means for ascertaining the worthlessness of the debt and must take all reasonable steps for the collection of the debt (C. S. Webb, Inc., 1 B.T.A. 269; Steele Cotton Mill Co., 1 B.T.A. 299). Furthermore, there must not be any reasonable expectation of collection at some future time (Portland Ry. Light & Power Co., 1 B.T.A. 1150; Steele Cotton Mill Co., 1 B.T.A. 299).

The only evidence which Appellant submits as to the worthlessness of the bonds in question is the fact that the National Banking Examiners required that they be charged off, and Appellant's statement to the effect that the market value of the bonds was only a small part of their book value.

Although the action of the bank examiners in requiring debts to be charged off may be regarded as prima facie evidence of worthlessness, if the action is based on a determination by the examiners that the debts are worthless such action is not sufficient to support the deduction if the charge off is required merely because of market fluctuations or if no attempt is made to ascertain the degree of recoverability (See 1933 Supplement to Klein, Federal Income Taxation, par. 20:21). In the instant case, the reasons for the action of the Bank Examiners in requiring that the bonds in question be charged off do not appear.

Furthermore, the very fact that the bonds had some market value, even though that market value were but a small portion of the book value, would seem to indicate that the bonds were not entirely worthless and hence that Appellant is not entitled to deduct the full amount of the bonds. It is true that the Act does not require that debts be ascertained to be entirely worthless, but provides that the Commissioner, when satisfied that a debt is recoverable in part only may allow such debt to be charged off in part. However, Appellant offers absolutely no evidence from which we could determine the degree of worthlessness of the bonds. Hence, even though the bonds may have been ascertained to be worthless in part, we have no other alternative than to sustain the Commissioner.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, that the action of Charles J. McColgan, Franchise Tax Commissioner, in overrulin the protest of First National Bank of Oceanside. against a proposed assessment of an additional tax of $101.21 under Chapter 13, Statutes of 1929, as amended, be and the same is hereby sustained.

Done at Sacramento, California, this 5th day of February, 1934, by the State Board of Equalization,

R. E, Collins, Chairman
Fred E. Stewart, Member
Jno. C. Corbett, Member
H. G. Cattell, Member

ATTEST: Dixwell L. Pierce, Secretary